

Financial Statements

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As you develop financial plans and make financial decisions to reach family goals, such as buying a car or house, accumulating an emergency fund, educating children, or retirement—or to adjust to changes such as a new job, a pay raise, marriage, divorce, widowhood—you first need to know your current financial situation.

Two tools are used to review a family's current financial situation: the net worth statement and the income/expense statement. This publication includes directions for the preparation and use of these statements.

NET WORTH STATEMENT

A net worth statement, also called a balance sheet, is a record of assets and liabilities; the difference between the two is net worth. Assets are the things you own with economic value. Liabilities are your debts, money you owe to others.

Your net worth statement tells you the fair market value of your assets today and the balance of your debts today. If you prepare a net worth statement about the same time each year, you will see how your assets, liabilities, and net worth change from year to year.

Do You Need One?

A net worth statement is a tool to measure progress toward meeting long-term financial goals, such as paying off major debts, financ-

ing your own or your children's education, saving for your own home, or saving for retirement. Before you formulate a plan to achieve goals, you need to know the resources you already have. A net worth statement visualizes your financial resources. Net worth statements are also useful as summaries of financial information. You may be asked for this financial information when you apply for credit, lease a car, or talk with a financial or estate planner.

Should everyone calculate net worth? Not necessarily. If you are struggling just to meet daily expenses, budgeting may be your first priority. Young families with few assets or debts may easily determine where they are financially without using a net worth form. However, before family members make decisions about investments, increasing debt, or purchasing insurance, they should know their present financial situation.

How Do You Prepare the Statement?

The easiest way to calculate your net worth is to use a preprinted form which provides a list of assets and liabilities such as the one that appears on page 3. Other forms are available from financial institutions and in many financial publications. Once you have read several, you may develop your own form, one that is just right for your situation. Here are some places to find information about the value of assets and liabilities:

- Car values are published by the National Automobile Dealers' Association and by Kelly Blue Book. These publications are available in libraries, at car dealers, and at lending institutions.
- The cash value of a whole life insurance policy can be found on a schedule in the policy. It is also available from your insurance agent. The cash value is the amount of money the insurance company would return to you if you terminated the policy today.
- Values of annuities are available in annual reports or periodic statements, or from your broker or insurance agent.
- Estimate the value of consumer goods by using information from second-hand shops and from classified ads. Use conservative estimates, because it is difficult to sell used possessions.
- The balance owed on installment debts or credit cards is listed on monthly statements from creditors.
- The principal owed on a mortgage is usually available on the end-of-the-year statement from the mortgage holder.

How Do You Use the Net Worth Statement?

A net worth statement is used to measure financial progress. Compare statements from year-to-year to determine if your assets are increasing and your debts decreasing. This annual comparison of your financial standing will provide an excellent point of refer-



ence for future financial management decisions.

In addition, you will use parts of your statement to analyze different objectives. If your objective is to analyze your retirement plan, you will be interested in the present value of your pensions, IRAs, and investments, as well as their projected future values.

If your objective is to determine how much property insurance you need on your home and its contents, you would itemize the value and estimate the replacement cost of the house and everything in it.

After completing your net worth statement, look at your assets. What assets do you have that are very liquid, that is, those that you can convert into cash quickly and easily? Checking accounts, savings accounts, money market funds, and money market deposit accounts are very liquid.

You need some liquid assets for emergencies. How much you need will depend on many factors—the likelihood of loss of income through unemployment, layoff, or illness, and the family's health and property insurance coverage. Some experts recommend that you keep an amount equal to two to three months' income in liquid assets; others recommend six months' income in liquid assets.

Will the value of your assets increase over time? Examples of assets that have the possibility of appreciating (growing in value) are mutual funds, stocks, and real estate. Some

NET WORTH STATEMENT

ASSETS

Cash

Cash on hand _____
 Checking account _____
 Savings account _____
Total Cash _____

Money loaned to others

(repayment expected) _____

Investments

Savings bonds _____
 Stocks and bonds _____
 Mutual funds _____
 Cash value of
 life insurance _____
 Cash value of
 retirement fund(s) _____
 Other _____
Total Investments _____

Personal Assets

Home and property _____
 Automobiles _____
 Personal property _____
 Other _____
Total Personal Assets _____

TOTAL ASSETS

LIABILITIES

Unpaid Bills

Taxes _____
 Insurance premiums _____
 Utilities _____

Credit cards

Total Unpaid Bills

Installment Loans

Home mortgage _____
 Automobile loan(s) _____
 Student loan(s) _____
 Bank loan(s) _____
 Other _____
 Other _____

Total Installment Loans

TOTAL LIABILITIES

NET WORTH

(assets - liabilities) _____

assets do not appreciate, but are income-producing assets. Examples are interest-bearing checking accounts, savings accounts, money market funds, money market deposit accounts, time deposits, and bonds. Are your income-producing assets producing what you consider a satisfactory return? What kind of balance do you want between growth (appreciating) assets and income-producing assets?

Some assets depreciate; they decline in value over time because of wear and tear and obsolescence. Examples are automobiles, home furnishings, and appliances. When will you have to repair or replace these assets?

Also review your liabilities. Have you borrowed money to purchase items such as a car, a mobile home, or a home? If so, how does the amount you presently owe compare to the present value of the item? It is best not to owe more than the item is worth.

Families borrow money for "investments in human capital." These are things that increase an individual's knowledge, skills, or well-being. Education and medical and dental care are examples of investments in human capital. They do not show up as financial assets on the net worth statement, but they do show up on the net worth statement as debts or decreased savings. Even though they decrease financial net worth, they are important to the family and to the individual.

Borrowing money for day-to-day expenses should be done only in emergencies. If you charge day-to-day items such as clothing, gasoline, and meals and you pay the total bill when it arrives, you are not borrowing money. If you make only the minimum payment, you are borrowing money for day-to-day expenses. If you do this routinely, you are using credit to live beyond your means.

INCOME/EXPENSE STATEMENT

An income/expense statement is a picture of your income and how you have spent your income for a given period in the past. This helps you compare income and expenditures with your goals and with what you think is important. You want to use your money for

the items and activities most important to you and your family.

Do You Need One?

Most families need to control their spending to meet basic needs and to accumulate funds for long-term goals. An income/expense statement is a tool to identify expenditures to reduce in order to increase saving. Income/expense statements are important during periods of transition. Each time there is an increase or decrease in income and each time there is an increase or decrease in expenses, a review of income and expenses identifies ways to adjust to the change.



An income/expense statement is not the same as a net worth statement. A net worth statement calculates your financial status at a point in time. An income/expense statement is a record of your income and outgo for a period of time in the past, usually 12 months. For example, a net worth statement lists the amount you owed on your car at the end of the year; an income/expense statement tells you the total amount you paid in car payments in the past year.

An income/expense statement is not the same as a budget. A budget is a plan for future expenditures and income; it can also be a running record of expenditures and income—or it can be both. While income/expense statements summarize income and expenditures over a longer period of time, usually a year,

and include future plans for a year, a budget usually controls spending for a shorter period—a week or a month. Therefore, a weekly or monthly budget can contain more details about the nature of income and of expenditures.

An income/expense statement is primarily a record of past expenditures, but it can also incorporate future planning by including a column for future or “this year” projections.

How Do You Prepare the Statement?

Some people calculate their income/expense statement around January 1, using figures from the previous calendar year. Others wait until they have completed their tax returns for the previous year and use income and expense calculations from the tax return. You can start and end an income/expense statement in any month and for periods other than a year.

You will find an income/expense statement form on page 6. Begin by listing your sources of income. The easiest way to obtain this information is to use your latest tax return. You also can use payroll stubs and listings of deposits in your checkbook. Remember to list all sources of income, including money from fellowships or scholarships, interest and dividends, and gifts.

Next list your tax expense from last year. This information is available on your tax return and on your paycheck stubs and wage statements. You probably have other deductions from your pay that fit into other categories.

Some expenses occur each month. These may be fixed: they are the same amount each month. Or they may be variable: they occur each month but the amount varies from month to month. Some examples of fixed expenses are rent or mortgage payments, car payments, alimony, and child support payments. Some examples of variable monthly expenses are food and gasoline.

The same expense category can be both fixed and variable. For example, in the category of utilities, a family might pay a set or fixed charge for local telephone service and a



INCOME/EXPENSE STATEMENT

Income

Wages and salary		
Adult earner	_____	
Adult earner	_____	
Dividends and interest	_____	
Capital gains and losses	_____	
Rents, annuities	_____	
Other	_____	
TOTAL INCOME		_____

Taxes

Personal income tax	_____	
FICA	_____	
TOTAL TAXES		_____

Living Expenses

Fixed

Variable

Housing		
Utilities	_____	_____
Repairs	_____	_____
Insurance	_____	_____
Property taxes	_____	_____
Rent or mortgage payments	_____	_____
Other _____	_____	_____
Food		
Clothing	_____	_____
Transportation		
Gas	_____	_____
Maintenance and repairs	_____	_____
Licenses and fees	_____	_____
Insurance	_____	_____
Auto payments or purchase	_____	_____
Recreation, entertainment, and vacations	_____	_____
Medical		
Doctor	_____	_____
Dentist	_____	_____
Medicines	_____	_____
Insurance	_____	_____
Personal	_____	_____
Life insurance	_____	_____
Outlays for fixed assets	_____	_____
Other expenses _____	_____	_____
_____	_____	_____
_____	_____	_____

TOTAL ANNUAL EXPENSES

Amount for Savings and Investment _____ + _____

variable amount for long distance calls. The same expense might be variable for one family, fixed for another. The Smiths have a set monthly local telephone rate (fixed), but the Browns have measured local service (variable).

Some expenses occur irregularly, perhaps only a few times in a year, and the amount may be fixed or variable. For example, car insurance is a fixed amount that may occur twice a year. Clothing and vacation expenses are variable and occur irregularly throughout the year.

The most convenient source of information for fixed expenses is your checkbook record. Multiply the amount of the fixed payment times the number of times you paid it during a year and enter that amount.

For variable expenses, list on a sheet of paper categories of these expenses (clothing, gasoline, car repairs, hobbies, food, etc.). Then go through your check register and record the amount of each expenditure under the appropriate category. If you find that checks were made out to MasterCard, Visa, or a department store for credit purchases, use the billing statement to determine how much was spent in which categories. If you had finance charges for your credit purchases, list them as "Finance charges" under "Other expenses."

For checks made out for cash or ATM withdrawals, when you do not know what the money was used for, list this amount as "Unaccounted-for cash" under "Other expenses." If this category is a high proportion of



your past expenditures, try to reconstruct an estimate of where this cash went.

To make this estimate, keep track of your cash expenditures for at least two weeks. You might find that during this time you spent one-fourth of your cash on gas, one-half on lunches out and coffee breaks, and the other one-fourth on groceries you purchased on the way home from work. Divide the total amount into appropriate categories using the same proportions and list in the "Unaccounted-for cash" category.

Add the expenditures in each category and enter the totals on your income/expense statement. Then add all the income and the expenses.

If your total income is greater than your total expenses, the difference should be the balance in your checkbook and/or cash on hand. If you came out with a surplus on paper but there is none in your checkbook, you probably underestimated your expenditures. On the other hand, if your expenses are greater than your income, you might have dipped into savings, taken out a loan, or underestimated your income.

This income/expense statement form is good for getting started, but after you have used it, you will probably want to create your own categories to fit your family. You might

want a category called “Meals out” or a special category just for “Sports equipment.” And you might not need some of the categories listed on this form.

Likewise, families with different styles of financial management can use the statement in different ways. A couple who pool their incomes would probably fill out one sheet. A couple keeping separate accounts might fill out two, one for each person. Some couples with separate accounts might also fill out a third sheet for their joint income or joint expenses.

After you have estimates for last year, think about your income and expenditures for next year. You will be able to predict some items fairly accurately; others will be estimates. Do the best you can. The better you estimate, the fewer financial surprises you will have during the year.

If your income is uncertain, estimate the highest and lowest income you expect for the year. Have an idea what expenses you will adjust if income is lower rather than higher.

How Do You Use the Income/Expense Statement?

An income/expense statement is the foundation for preparing a budget or spending plan. Without the income and expense information, it would be difficult to make realistic budget estimates.

As a wise financial manager, you use a budget to reach your financial goals. The budget will help you live within your income by spending your money wisely.

For assistance in developing a budget, order Bulletin 311, *Make Your Money Go Further—A Budgeting Booklet*. This booklet costs \$2.00 and can be purchased from your local Cooperative Extension office. You will find their telephone number and address in the blue pages of your telephone book.



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